

DIRECT TESTIMONY OF

JIMMY E. ADDISON

ON BEHALF OF

SOUTH CAROLINA ELECTRIC & GAS COMPANY

DOCKET NO. 2009-489-E

Q. PLEASE STATE YOUR FULL NAME AND BUSINESS ADDRESS.

A. My name is Jimmy E. Addison and my business address is 220 Operation Way, Cayce, South Carolina. I am Senior Vice President and Chief Financial Officer ("CFO") of South Carolina Electric & Gas Company (the "Company" or "SCE&G") and hold a similar position at SCANA Corporation, which is the parent company of SCE&G.

Q. DESCRIBE YOUR EDUCATIONAL BACKGROUND AND BUSINESS EXPERIENCE.

A. I am a graduate of the University of South Carolina with a Bachelor of Science Degree in Business Administration, majoring in accounting, and a Master of Accountancy Degree. Also, I am a Certified Public Accountant in South Carolina. Prior to my employment by the Company in March 1991, I was employed for seven years by the public accounting firm of Deloitte & Touche, where I was designated an Audit Manager as a public utility accounting and audit specialist. I was also a partner in the public

1 accounting firm of Hughes, Boan and Addison immediately prior to joining
2 the Company in 1991.

3 **Q. WHAT ARE YOUR DUTIES WITH SCE&G?**

4 A. As Senior Vice President and Chief Financial Officer of SCE&G, I
5 have responsibility for monitoring the Company's present and prospective
6 financial condition; for formulating strategies to ensure that the Company
7 can meet its capital requirements at the lowest reasonable cost; and for
8 managing all accounting and financial matters related to the Company. In
9 that regard, I meet regularly with members of the financial community,
10 including the Wall Street analysts and credit rating agency personnel who
11 follow the electric utility industry in general and SCE&G specifically. In
12 these meetings, we discuss their perceptions and concerns about the
13 Company, its financial and business position, the capital markets and the
14 utility industry generally. We also discuss the various risk factors that the
15 Company faces as seen by investors. I am also regularly involved in
16 discussions of investors' perspectives on the Company with underwriters
17 and other experts as such views pertain to the issuance or refinancing of
18 debt and the issuance of new common stock.

19 **Q. HAVE YOU EVER TESTIFIED BEFORE THIS COMMISSION IN**
20 **THE PAST?**

21 A. Yes. I have testified before the Public Service Commission of South
22 Carolina (the "Commission") in numerous proceedings.

1 **Q. WHAT IS THE PURPOSE OF THE TESTIMONY YOU ARE**
2 **PRESENTING IN THIS CASE?**

3 A. The principal purposes of my testimony are:

- 4 • First, I will discuss the need and importance of the requested rate
5 increase from the standpoint of the Company's need for continued access to
6 capital markets.
- 7 • Second, I will discuss the Company's future financial plans in terms
8 of anticipated capital expenditures, anticipated stock and bond issues and
9 sources of capital.

10 **Q. PLEASE PROVIDE THE COMMISSION WITH A FINANCIAL**
11 **OVERVIEW OF SCE&G'S RATE INCREASE REQUEST IN THIS**
12 **PROCEEDING.**

13 A. In this proceeding, the Company is seeking an increase in its retail
14 electric rates of \$197.6 million based on a test year ended September 30,
15 2009. The test period in SCE&G's last electric rate proceeding, Docket
16 No. 2007-229-E, closed on March 31, 2007. Since that time, SCE&G has
17 spent a total of approximately \$633 million in capital on mandatory
18 environmental upgrades to its generation plants. The Company has also
19 made substantial additional investments to ensure the safety and reliability
20 of its system and to serve new customers. These investments were
21 primarily investments in its transmission and distribution systems but
22 included other assets as well. These investments represent an increase to

1 net plant of approximately \$270 million. The Company also spent
2 approximately \$330 million on the federally mandated remediation of the
3 Saluda Dam, although through its unregulated investment in Synthetic Fuel
4 Tax Credits the Company was able to defray 77%, or all but approximately
5 \$75 million of this cost. To support the reliability of its service in the
6 Charleston Peninsula area, the Company has installed two additional simple
7 cycle gas turbines at Plant Hagood at a cost of approximately \$45 million.
8 Collectively, these investments represent more than \$1 billion in additional
9 investment in plant in service which is not currently reflected in rates.

10 This capital investment, along with other items, has reduced the
11 Company's test year pro-forma return on equity to 6.82%, as compared to
12 the 11.0% return that the Commission authorized in 2007. As I discuss
13 later in my testimony, today's capital markets are uncertain, the standards
14 imposed by rating agencies for investment grade credit ratings are
15 increasingly demanding, and the Company needs to access significant
16 amounts of capital in the near term. Therefore, I concur with Mr. Hevert
17 that an appropriate return on equity for SCE&G is 11.6%.

18 **Q. PLEASE DESCRIBE THE TIMING OF THIS FILING.**

19 A. To mitigate the impact of this increase on its customers, and in light
20 of the unique nature of the current economic environment, SCE&G has
21 delayed the request for this increase as long as practicable. In a typical
22 environment, given the level of investment SCE&G has made in its

1 generation, transmission and distribution system, the Company would have
2 filed this proceeding one year earlier. But late 2008 and early 2009 was the
3 time of frozen financial markets, plummeting stock markets and rapidly
4 increasing unemployment. Major financial institutions either failed or had
5 to be bailed out by the Federal government. In light of the recession and
6 the turmoil in the financial markets during that time, we sought to delay
7 filing this case as long as possible by cutting or deferring costs. This has
8 benefited customers by delaying the impact of new rates as long as possible
9 and avoiding a rate increase during this critical time. In addition, we have
10 structured our request in this case to allow the required rate increase to be
11 delayed in part and implemented in three phases so that the full increase
12 does not go into effect until July 1, 2011. All of these are ways the
13 Company has sought to avoid or mitigate rate increases during the height of
14 the financial crisis. But the need for rate revision is real. In my opinion, as
15 Chief Financial Officer of the Company, rate relief cannot be delayed
16 further without risking substantial long-term harm to the Company and its
17 customers. I fully understand that the economy remains in a difficult
18 position; however, the fear of catastrophic collapse experienced in late
19 2008/early 2009 has passed, and the economy now appears to be on a slow
20 climb out of this recession.

21 **Q. PLEASE DESCRIBE THE COMPANY'S PHASED**
22 **IMPLEMENTATION OF THE REQUESTED RATES.**

1 A. The Company is proposing that the initial rate adjustment (“Phase
2 1”) be effective on July 15, 2010 and represent \$66.14 million in
3 incremental revenue, or a rate increase of approximately 3.19% compared
4 to current rates. The second rate adjustment (“Phase 2”) is proposed to be
5 effective January 1, 2011 and represents an additional incremental revenue
6 requirement of \$63.52 million, or an increase of approximately 3.06%
7 compared to current rates. Finally, the full amount of the proposed increase
8 (“Phase 3”) would be effective on July 1, 2011 and would represent an
9 additional incremental revenue requirement of \$67.91 million, or an
10 increase of approximately 3.27% compared to current rates. Under this
11 proposal, the majority of the increase will be deferred until 2011, or
12 eighteen months from the date of the request allowing for further
13 strengthening of the economy.

14 **Q. IS IT POSSIBLE TO IDENTIFY THE CHANGES IN THE**
15 **COMPANY'S FINANCES THAT HAVE RESULTED IN THE NEED**
16 **FOR RATE ADJUSTMENTS AT THIS TIME?**

17 A. Yes. But it is important to recognize that hundreds of expense,
18 capital and revenue items are netted together to determine the Company's
19 financial results in each period. These expense, capital, and revenue items
20 can vary in opposing directions and can change in offsetting or
21 compounding ways. As a result, an accurate view of how the Company's
22 revenue and expense profile is changing cannot be obtained by viewing any

1 single component or group of components in isolation. However, I can
2 identify some of the principal changes in the Company's financial profile
3 since the 2007 rate proceeding that have resulted in the need for the rate
4 adjustments presented in this case.

5 The revenue requirement associated with mandatory environmental
6 and safety projects discussed above constitutes 54% of the additional
7 revenue requirement in the application. The Company continues to be one
8 of the largest taxpayers in the State of South Carolina. The Company's bill
9 for taxes other than income taxes is approximately \$140 million, which is
10 principally comprised of property taxes. This bill has increased by \$17
11 million since the test period on which current rates were set, and represents
12 approximately 8% of the requested increase. Taxes, combined with the
13 governmentally mandated environmental and safety investments mentioned
14 above, represent 62% of the requested increase. The Hagood turbines
15 discussed by Company Witness Byrne were a necessary addition to our
16 generation portfolio to replace older units that were retired due to safety
17 concerns. The costs associated with these turbines represent approximately
18 4% of the increase.

19 In addition to the above, as mentioned earlier, to maintain the safety
20 and reliability of its system, and to serve new customers, the Company has
21 invested \$270 million in its net plant since the last rate proceeding. This
22 investment represents 18% of the increased revenue requirement. As Mr.

1 Marsh and Mr. Byrne testify, the Company recognizes in its request the
2 need to increase funding for its tree trimming and vegetation control
3 programs and to update its major maintenance accrual associated with
4 maintaining its coal plants and combined cycle gas turbines. These two
5 items represent investments in the continued reliability of the Company's
6 electric system and in the protection of system assets from failure and
7 damage. They represent 9% of the additional revenue requirement in this
8 case. In addition to these specific items, the Company has experienced the
9 effects of general inflation in the economy since the last rate proceeding.

10 While items such as these are putting upward pressure on revenue
11 requirements, the Company has partially off-set them:

- 12 1. By implementing reduced depreciation rates;
- 13 2. By generating and proposing to accelerate the recognition of certain
14 South Carolina investment tax credits;
- 15 3. By voluntarily using Federal Synthetic Fuel Tax Credits to off-set
16 77% of the cost of the Saluda Dam remediation;
- 17 4. By successfully controlling non-fuel O&M growth; and
- 18 5. By significantly reducing its capital budgets.

19 As to this latter item, in light of the current economic circumstances,
20 SCE&G has made a commitment where possible to defer capital spending
21 and O&M spending not required for reasons of safety, reliability or
22 providing excellent service to customers. As a result, SCE&G has cut its

1 2010-2012 capital budget for non-nuclear electric spending by
2 approximately \$250 million. Capital spending in 2009 was also
3 approximately \$230 million less than the 2008 amount.

4 While consumer inflation has been at historically low levels since
5 late 2008, it is also the case that from March 2007 to September 2009, the
6 electric industry producer price index (“PPI”) has increased by 9.9%. This
7 increase has a direct impact on SCE&G’s cost of doing business. However,
8 as discussed below, SCE&G’s non-fuel O&M expense for 2009 was less
9 than 2008 levels. The Company has diligently managed costs where it can
10 do so without putting the safety, reliability and efficiency of the electric
11 system in jeopardy. Analysts have acknowledged our industry leadership
12 in the area of cost reduction during this recession.

13 However, when all these items are netted together, the result is that
14 current rates do not allow SCE&G the ability to earn a return that will allow
15 the Company to continue to access necessary capital on reasonable terms.
16 As mentioned above, the Company’s pro-forma return on equity is
17 currently only 6.82%, compared to an authorized level of 11.0%. Earnings
18 at these levels will not allow the Company to maintain its current debt
19 ratings or reasonable valuations of its stock. The Company is currently in a
20 major construction cycle and access to capital on reasonable terms is of
21 paramount importance. As stated earlier, the Company waited as long as

1 reasonably practicable in filing for rate relief, but these conditions make the
2 requested rate adjustments necessary.

3 **Q. WHAT ARE THE COMPANY'S CAPITAL NEEDS AT THIS TIME?**

4 A. As the Commission is aware, the Company is building two
5 Westinghouse AP-1000 advanced passive pressurized water nuclear
6 reactors in partnership with the South Carolina Public Service Authority
7 ("Santee Cooper") in Jenkinsville, South Carolina. Construction on these
8 units began in September of 2008. As of year-end 2009, Santee Cooper
9 and SCE&G had spent a total of \$853 million on the project. By year end
10 2010, that amount is projected to be \$1.7 billion. While investments are
11 being managed under the terms of the Base Load Review Act, they are an
12 important part of SCE&G's capital plans and how its business is seen by
13 the investment community.

14 In addition to investment in nuclear generation, SCE&G must also
15 continue to invest in its electric system to maintain its safety, reliability,
16 and efficiency, and to serve new customers on its system. As mentioned
17 above, in response to current economic conditions, SCE&G has drastically
18 cut its capital spending on its electric system and has delayed non-essential
19 capital spending whenever possible. However, safety and reliability are not
20 optional, and worn out or aging equipment must be replaced before it fails.

21 Extending service to new customers who require it is also not
22 optional. SCE&G has an obligation to meet the service needs of its

1 customers. In 2009, in the midst of the worst economic contraction in 75
2 years, SCE&G added approximately 5,200 net new customers to its system.
3 Even in the current economic circumstances, customer growth on our
4 system has not stopped. We forecast a modest rebound in sales growth
5 after the current recession and continued demand growth at 1.5% per year
6 going forward.

7 For all these reasons, SCE&G's foresees the need to invest
8 approximately \$3 billion in new capital in its electric system in the 2010-
9 2012 period. Of that amount, approximately \$2 billion will finance new
10 nuclear construction and more than \$1 billion will be invested in other
11 assets needed to provide reliable energy service to our electric customers.

12 **Q. HOW WILL THE COMPANY MEET THESE NEEDS?**

13 A. During the three-year period from 2010 to 2012, SCE&G plans to
14 issue \$850 million in new debt and SCANA plans to issue an additional
15 \$735 million in new equity. The new SCANA equity is being issued solely
16 to support SCE&G's capital needs and, accordingly, will be passed down to
17 SCE&G in totality. The balance of the \$3 billion capital budget will be
18 funded with internally generated funds, including the reinvestment of
19 undistributed shareholder earnings. Approximately ten years ago, SCANA
20 made the decision to lower its dividend payout rate to retain additional
21 earnings to invest in its system. I might note that our current dividend

1 payout ratio is lower than the industry average, leaving SCE&G with
2 millions of dollars of shareholders' earnings to reinvest in our business.

3 **Q. WILL SCANA GO TO THE MARKET FOR OTHER CAPITAL**
4 **NEEDS?**

5 A. Yes. In addition to these new long-term financings, SCANA plans
6 to refinance \$850 million in existing long-term obligations scheduled to
7 mature during the three year period from 2010 to 2012. Also, SCANA
8 maintains a \$1.1 billion medium-term credit facility which provides critical
9 liquidity to SCE&G and certain of SCANA's other subsidiaries when
10 market conditions do not allow issuances of short-term commercial paper at
11 reasonable rates. Of the \$1.1 billion amount of this facility, \$650 million is
12 devoted to SCE&G's needs for short-term liquidity. The current credit
13 facility expires in December 2011 and will likely be renewed in 2010.

14 **Q. HOW IMPORTANT WILL THE OUTCOME OF THIS**
15 **PROCEEDING BE TO THE COMPANY'S ABILITY TO EXECUTE**
16 **ITS CAPITAL INVESTMENT PLAN?**

17 A. As stated above, SCANA and SCE&G have announced plans to
18 enter the markets over the next three years to seek a total of \$2.4 billion in
19 capital. As a result, the investment and banking communities are very
20 sensitive to the key drivers of our business, none of which is more
21 important than the regulatory treatment provided to our electric system by
22 this Commission.

1 On an immediate level, this case is about a real deficiency in the
2 Company's revenues caused by the revenue requirement associated with
3 approximately \$1 billion of recent capital investment, much of which is
4 mandated by federal law, that is not reflected in rates, and other costs. In
5 2009, the Company's debt ratings were downgraded one notch, from A to
6 A-, in part because its revenues did not produce flows of funds from
7 operations, debt service coverage ratios and other financial metrics that
8 would justify its then-existing rating. In addition, the debt rating agency
9 Moody's has placed the Company on negative outlook for further possible
10 downgrades, with financial metrics as one of the principal areas of concern.
11 Without a substantial increase in revenues as requested in this proceeding,
12 it will be impossible for the Company to absorb the costs associated with
13 the approximately \$1 billion in recent investment and still maintain its
14 current debt ratings and access to capital. Further downgrades in our credit
15 ratings would both increase the cost of capital to the Company, and in some
16 markets, could make access to capital more difficult. Obviously in the
17 long-term these risks and costs are borne by the customers.

18 **Q. IS THIS PROCEEDING IMPORTANT FOR OTHER REASONS?**

19 A. Yes. As mentioned above, part of my responsibilities as CFO is
20 monitoring and safeguarding the Company's access to capital and
21 maintaining its relationships with the investment community. As a result, I
22 meet or speak regularly with investment analysts, rating agency personnel,

1 underwriters, hedge fund and private equity fund representatives and others
2 in the investment community. There is a clear understanding among all of
3 these groups that SCE&G's plan for financing the new nuclear units and
4 meeting its electric system's needs is practical and achievable. But the
5 investment community also understands that the plan depends entirely on
6 the belief, based on past experience, that the Company will receive
7 reasonable and constructive treatment in the regulatory process over the
8 next decade. The belief that on-going regulation in South Carolina will be
9 balanced and constructive is the product of decades of consistent and fair
10 decisions by this Commission. In short, this belief is about the trust of
11 investors in both management and regulators that a long-term view will be
12 maintained.

13 It is important to understand, as Mrs. Cannell testifies, that the
14 investment community's support for the Company's financial plan, and the
15 A to A- rating for SCE&G's senior secured debt, has been expressly stated
16 to be based on the belief that the Company will receive fair and
17 constructive regulatory treatment in this proceeding. For many years the
18 financial community has seen regulation for SCE&G's electric system as
19 fairly and appropriately balancing needs of customers, investors and the
20 State of South Carolina. As shown in the excerpts from investment
21 analysts' reports that Mrs. Cannell presents in her testimony, the investment

1 community fully expects that this balanced and constructive regulatory
2 pattern will continue.

3 **Q. WHAT SPECIFIC FACTORS INFLUENCE INVESTORS' VIEW OF**
4 **THIS CASE?**

5 A. The investment community understands that the current economic
6 conditions place new pressures on regulatory environment regulation in
7 South Carolina. Investors will look carefully at the results in this
8 proceeding to see what effect those pressures will have. However, the
9 investment community views this case as largely focused on more than \$1
10 billion in investment in the Company's generation, transmission and
11 distribution systems, much of which is mandatory investment to meet
12 federal environmental and safety requirements. The investment community
13 is likely to view a decision which does not allow the full recovery of these
14 investments as a signal that the regulatory environment in South Carolina
15 has changed in a negative way.

16 If the investment community sees this proceeding as creating
17 uncertainty about the consistency of the regulatory treatment that SCE&G
18 will receive over the next decade, then the terms on which SCE&G will be
19 able to issue the debt and equity to support its capital needs would change
20 significantly for the worse. The Company may lose the ability to raise
21 capital on reasonable terms to support construction of its nuclear units and
22 to meet other needs of its system.

1 **Q. CAN YOU QUANTIFY THE EFFECTS OF LOWER STOCK**
2 **VALUATION OR DEBT RATINGS ON SCE&G'S FINANCES AND**
3 **CUSTOMERS?**

4 A. It is possible to give some examples of how lower stock valuation
5 and lower debt ratings could affect SCE&G's finances and its customers.
6 Take as a hypothetical situation the assumption, that as a result of a loss of
7 investor confidence in SCANA's ability to execute its financial plan, the
8 valuation of SCANA's stock was depressed by 10% during the period that
9 it plans to issue the \$735 million in new stock called for in its current
10 financial forecast. If SCANA's stock were trading at about \$36 per share
11 before the valuation dropped, SCANA would be required to issue
12 approximately 21.1 million shares to generate \$735 million, assuming
13 flotation costs of 3.5%. At the 10% lower price of \$32.40, SCANA would
14 need to issue approximately 23.6 million shares. SCANA would be
15 required to support each of these additional shares with dividends so long
16 as they were outstanding. SCANA paid a dividend of \$1.88 in 2009, and
17 would expect that dividend to increase by 4-6% annually going forward.
18 As a result, the dividends paid on the additional shares of stock would be
19 between approximately \$142 and \$179 million over 20 years. The earnings
20 needed to support these additional shares would be approximately double
21 that amount.

1 Similarly, in today's markets a reasonable measure of the additional
2 interest cost for a Senior Secured BBB+ debt rating compared to A- debt
3 rating is approximately 10 basis points and it could grow substantially
4 wider. If you apply this spread to the interest cost on the \$850 million in
5 new debt that SCE&G plans to issue in the next 3 years and the \$150
6 million SCE&G will be refinancing, the incremental interest expense over
7 the life of the financings is \$30 million. This effect would be compounded
8 by financings and refinancings outside of the current 3-year forecast, which
9 will be substantial given new nuclear development and the scheduled
10 maturity of existing debt. In other words, if the result in this proceeding is
11 considered reasonable and fair by rating agencies and the investment
12 community, it could save the Company, and ultimately its customers,
13 hundreds of millions of dollars in capital expense over the next 30 years.
14 Or to put it another way, the balance between immediate rate impacts and
15 the potential long term effects on the economics of SCE&G's electric
16 system is something that we hope that the Commission will carefully
17 consider as it evaluates the positions of the parties in this proceeding. This
18 is especially true given the fact that the Company is currently in a major
19 construction cycle and will need to go to the markets to acquire large
20 amounts of capital in the next three years.

1 **Q. HOW DOES THE BASE LOAD REVIEW ACT FIGURE IN THIS**
2 **ANALYSIS OF THE REGULATORY RISKS TO SCE&G’S**
3 **FINANCING PLANS FOR THE NEW NUCLEAR UNITS?**

4 A. The Base Load Review Act provides for annual revised rate
5 adjustments which in turn create revenues to support the incremental cost
6 of financing the new nuclear units while they are being built. But the
7 financial community invests in SCE&G and SCANA as consolidated
8 businesses. There is no separate investment vehicle for the nuclear
9 business. SCANA has only one class of common stock. SCE&G reports
10 only one set of earnings and one set of debt service coverage ratios and
11 other financial metrics. The ability to finance nuclear construction cannot
12 be decoupled from the returns earned on core electric operations.

13 Investors will not benefit from Base Load Review Act revenues if
14 they are absorbed or offset by other aspects of SCE&G’s electric business
15 failing to earn a reasonable return. If revenues from its core electric service
16 are insufficient, overall earnings, coverage ratios and other metrics of the
17 Company’s financial health will be insufficient to support the financing
18 needs of the nuclear construction project.

19 **Q. PLEASE EXPLAIN WHY YOU BELIEVE THAT 11.6% IS AN**
20 **APPROPRIATE RETURN ON EQUITY FOR SCE&G?**

21 A. As the Commission is aware, today’s capital markets are
22 characterized by volatility and uncertainty, restraints on liquidity and

1 increasingly demanding standards imposed by rating agencies for
2 investment grade credit ratings. In 2007, the Commission approved an
3 ROE for the Company of 11.0% with rates being set on an ROE of 10.7%.
4 Markets have not improved since 2007, and systemic risk has increased.

5 The Company believes that an ROE of 11.6%, as testified to by Mr.
6 Hevert, would represent a positive and clear statement of support for the
7 Company and its plans for meeting its capital needs going forward. The
8 revenues generated by earning at this level would provide much needed
9 support for the Company's debt coverage ratios and other financial metrics.
10 Additional earnings would greatly assist SCE&G in maintaining its current
11 credit ratings and avoiding incremental financing costs. The additional
12 revenues also would help the Company maintain a favorable valuation for
13 its common equity. In short, establishing an ROE at the 11.6% level would
14 assist the Company in reducing its cost of capital over the long term and
15 maintaining its access to capital in very volatile and uncertain markets.
16 Given the amounts of capital that the Company will need to raise in the
17 near term, providing a positive signal to the investment community could
18 not come at a more critical time for the Company and its customers. For
19 these reasons, I support a return on equity for SCE&G of 11.6% as
20 reasonable and appropriate.

21 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

22 **A.** Yes. It does.